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Mr. David S. Guzy
Chief, Rules and Procedures Staff
Minerals Management Service
Royalty Management Program
P. O. Box 25165, MS 3101
Denver, CO 80225-0165

RE: Amendments to Gas Valuation Regulations for Federal Leases (60 FR 56007, November 6, 1995); Reopening of Public Comment Period (60 FR 24521, May 21, 1996)

Dear Mr. Guzy:

On behalf of the Rocky Mountain Oil & Gas Association (RMOGA), I am writing to offer supplemental comments pursuant to the reopened public comment period on the above-referenced Notice of Proposed Rulemaking (Concensus Rule). RMOGA submitted comments supporting the Concensus Rule on February 5, 1996, and hereby incorporates those comments by reference. We *also incorporate by reference comments made by RMOGA's representative, Bob Fox, at the public* hearing in Houston on January 22, 1996.

Although the majority of commentors supported the Concensus Rule, the Federal Gas Valuation Negotiated Rulemaking (Reg-Neg) Committee was reconvened June 12, 13, and 14, 1996, to address negative comments MMS had received on the Concensus Rule, primarily from small independent producers and the states. It should be noted that, because of strong support throughout industry for the Concensus Rule, there were no other significant adverse comments received from industry trade associations other than the IPAA/IPAMS concerns regarding the increased audit burden.

MMS distributed a summary of those negative comments as well as several proposed options to address them. Four of the five options proposed by MMS were a dramatic departure from the Concensus Rule. Moreover, these options failed completely to address the concerns of the small independent producers, and instead, moved toward the position of the few state commentors. It is disconcerting that MMS would give so much weight to the comments of these states while fundamentally ignoring the comments of the small, independent producers.

Meanwhile, an industry coalition comprised of industry representatives on the Reg-Neg Committee and other interested industry participants drafted an alternative proposal (Unified Proposal - see attached) that is supported by virtually the entire industry. The Unified Proposal adequately addresses the problems with the Concensus Rule identified by MMS in its options paper, including the independent producer concerns. During the reconvening of the Reg-Neg Committee, the Unified Proposal was rejected by both MMS and the states, yet the options presented by MMS or the states addressed neither the solutions posed by the Unified Proposal nor the independent producer concerns.

RMOGA strongly supports the Unified Proposal, believing it alone deviates the least from the Concensus Rule of any of the proposed options, yet it addresses the legitimate concerns raised by independent producers in their comments. The Unified Proposal significantly reduces MMS' administrative burden in having to calculate the safety net because it eliminates the requirement to audit gross proceeds payors in order to calculate the safety net median value. It greatly simplifies the process by eliminating the option to pay residue on index and liquids on gross proceeds and by expanding the lessee's ability to report and pay processed gas royalty on a wellhead MMBtu. It provides a practical exception to reporting entitled volumes on mixed agreements. And, last but certainly not least, it substantially increases the safety net cap, which appropriately addresses concerns about revenue neutrality.

During discussion at the reconvened Reg-Neg Committee meeting, the Unified Proposal was modified by industry as an additional option (Option No. 7) which would stipulate that index payors would true up to <u>90%</u> of the difference between the index payor's weighted average index based value and the median price for unaudited gross proceeds on a zone-by-zone basis (see Unified Industry Proposal, attached, No. 11). In addition, the Unified Proposal was modified to indicate that: "Gross proceeds payors would be allowed to value small <u>non-arm's-length, non-sale dispositions of royalty-bearing</u> volumes of gas <u>(for example, off-lease fuel)</u> in accordance with its arm's-length transactions and would not be required to use index pricing" (see Unified Industry Proposal, attached, No. 14).

After further discussion, an additional option modifying the Unified Proposal was offered (Option No. 8) which indicated that gross proceeds payors would have an option to apply a gross proceeds based gas value to the wellhead MMBtu less applicable transportation with <u>a 30% true up to 101% of the</u> safety net median value (see Unified Industry Proposal, attached, No. 8). In addition, the proposal was modified to reflect that index payors would true up to <u>50% or 65% (as set forth originally in the Committee recommendation)</u> of the difference between the index payor's weighted average index based value and <u>101% of the safety net median value</u> for unaudited gross proceeds on a zone-by-zone basis. <u>(MMS could audit gross proceeds payors but adjustment reason codes of 40+ would not go into the safety net. Adjustments due to exception processing would be included.)</u> (See Unified Industry Proposal, attached, No. 11.) Finally, industry agreed that if the safety net is not published within two (2) years following the end of the index year, no additional royalty would be due (see Unified Industry Proposal, attached, No. 12).

RMOGA still supports Option No. 8, but only as it modifies the original Unified Proposal. RMOGA encourages serious consideration of the concept under which the incremental percentage would be based on substantiated audit results, for example, the amount of additional royalty received each year through audit activities as a percentage of total revenues received.

RMOGA also directs MMS' attention to its comments at the public hearing in Houston. The only modification to those comments RMOGA would make at this time is in regard to the safety net issue. If a safety net provision is to be included in the proposed regulations, RMOGA supports the industry's Unified Proposal as modified by Option No. 8.

MMS OPTIONS

MMS' proposed Option No. 1 adheres most closely to the Concensus Rule; however, Option No. 1 continues to ignore the concerns addressed in the independent producers' comments on the Concensus Rule. Following are our specific comments on each point of Option No. 1.

OPTION NO. 1

Point One proposes writing the rule in plain English. RMOGA supports this objective with the caution that, should unamended portions of the regulations require revising, care be exercised to avoid making any substantive changes to the regulations. We recommend the preamble include a disclaimer expressing that the plain English revisions are made with no intent to substantively alter the meaning of the existing regulations. In addition, the preamble should state that incorporating the Committee concensus into the existing regulations should not be interpreted or infer that any concensus was reached on longstanding differences of opinion on the meaning and interpretation of existing regulations, or that these differences of opinion were waived or withdrawn.

Point Two proposes to adopt "minor technical and procedural improvements" suggested by commentors. RMOGA cannot comment on these technical and procedural improvements because we do not know what they are. In addition, industry must be given adequate time to review and analyze them once they are known.

Point Three deletes the second sentence of proposed 30 CFR 202.450(b) which would deny the royalty-free use of gas downstream of the Facility Measurement Point (FMP). RMOGA supports the change, since this provision was not agreed to by the Reg-Neg Committee and appears to have been included in the Concensus Rule by mistake.

Point Four includes a provision for takes based reporting for 100% Federal agreements and stand-alone leases. RMOGA supports the position taken by the Reg-Neg Committee during the June 1996 meeting which includes an exception to pay on other methods as specified in the original "MMS Proposal on Takes".

Point Five grants an additional six months beyond the two year period agreed to by the Committee for MMS to calculate and publish the safety net median value. RMOGA reminds MMS of the assurances it made during Reg-Neg Committee negotiations that it could accomplish this calculation within two years. To now assert an extra six months may be required is unfair and will deprive industry of certainty of royalty valuation at as early a date as possible. To the extent that MMS' timely publication of the safety net median value may be delayed in the event of future government furloughs, RMOGA could support an exception that would provide for additional time to publish the safety net median value, but only for a length of time commensurate with the duration of the furlough. However, every effort should be made by MMS to honor its commitment to calculate the safety net within two years.

Point Six requires index based payors to pay royalty on contract settlement proceeds received from settlements entered into after the effective date of the rule. RMOGA is still opposed to this concept. We reiterate the following comments in our letter of February 5, 1996:

> "It should be noted the Reg-Neg Committee agreed to exclude royalties paid on contract settlements from the safety net calculation. Moreover, when the Committee reached consensus on the concept of a safety net calculation, MMS agreed not to assess royalties on any other basis. Finally, the index based valuation method prohibits lessees from recapturing payments in excess of index value when index value exceeds the safety net median value.
>
> Therefore, because we believe index prices are indicative of market value, RMOGA continues to support the position that additional royalties are not and should not be due on proceeds from gas contract settlements either before or after the effective date of this rule. Moreover, this issue was not addressed in the Committee Report and no consensus was reached by the Committee. Furthermore, this is a matter currently under litigation. Therefore, this section should be deleted from the final rule."

Point Seven would permit a credit from overtaken volumes by a small producer paying on takes to be processed through a recoupment based on a weighted average value of the previous year's sales. RMOGA could support this concept, but only if the credit can be achieved through recoupment, credit, offset, or refund, and be based on the actual value on which the royalties were overpaid.

Point Eight would have MMS issue separate guidance on reporting of gas valuation consistent with the recommendations of the Royalty Policy Committee Subcommittee on Royalty Reporting and Production Accounting. RMOGA strongly endorses this provision.

Point Nine would require MMS to publish a separate rulemaking on benchmark valuation. RMOGA admonishes MMS to consider not only the comments submitted pursuant to the Concensus Rule but also the deliberations of the Reg-Neg Committee as recounted in the Committee Report on pages 54-55 and the minutes from the January 30-February 3, 1995, meeting.

The following Options, Nos. 2-5, deviate radically from the Concensus Rule, more closely addressing the concerns of the states, while continuing to disregard the independent producers' concerns. As such, RMOGA cannot support any of these Options. Following are our specific comments on Options Nos. 2-5.

OPTION NO. 2

This Option would retain the Concensus Rule index based method, but replace the MMS-calculated safety net with a safety net calculated by the index payor based on its own arm's-length sales, including sales by an affiliate. If the difference between the lessee's weighted average index payments and its weighted average pool price exceed a certain tolerance, either additional royalty due or a refund would be required.

RMOGA strenuously opposes Option No. 2 for several reasons. First, industry maintains that index prices, net of transportation costs, are indicative of market value of production at the lease. Therefore, industry opposed the safety net concept during Reg-Neg Committee deliberations, but finally agreed to it, in the spirit of compromise, to alleviate MMS' and states' concerns about revenue neutrality. However, a safety net based on the index payor's weighted average pool price was discussed and rejected by the Reg-Neg Committee in favor of a calculation based on MMS-2014 information reported by gross proceeds payors.

Second, Option No. 2 gains absolutely nothing. Lessees would still be required to trace production through pools, resulting in weighted average prices that would be subject to numerous retroactive adjustments, rendering index based payments as merely estimated payments subsequently adjusted to gross proceeds. This regressive proposal seems designed to settle everyone in the predicament that has become the universe under the 1988 regulations: allocations based on assumptions where actual tracing cannot be done; difficult, time-consuming audits; disputes over gross proceeds, allowable deductions, affiliate resales, and so on!

Third, Option No. 2 requires lessees to perform dual accounting. Imposition of this burden fails to acknowledge concessions made by industry in order to attain an alternative valuation methodology.

OPTION NO. 3

Option No. 3 addresses concerns expressed by a mere three of 44 commentors: STRAC, and the States of Colorado and Montana. Because these concerns were exhaustively discussed and balanced against offsetting concerns by the Reg-Neg Committee, RMOGA is opposed to implementation of Option No. 3. Indeed, even the representatives of the above-mentioned three commentors expressed concerns with certain aspects of Option No. 3 during the Reg-Neg Committee meeting in June 1996. RMOGA's specific comments follow.

Point One would require index applied to a wellhead MMBtu; eliminate the option to pay index on residue gas and gross proceeds on liquids; and eliminate wellhead MMBtu reporting based on the gross proceeds residue gas price. RMOGA could support eliminating the option to pay index on residue and gross proceeds on liquids only if the appropriate transportation allowances are retained; but RMOGA opposes eliminating wellhead MMBtu reporting based on the gross proceeds residue price.

As you know, industry made numerous concessions during the Reg-Neg Committee deliberations. Among those concessions, industry agreed to forego two separate safety nets for processed and unprocessed gas in lieu of a single safety net for unprocessed gas, processed gas, and NGLs. Industry also agreed to an increase in the true-up percentage, acknowledging that there may sometimes be uplift due to processing and difficulties in auditing gas plants. Because of those concessions, it would be unjust for MMS to now eliminate this option for gross proceeds payors. Moreover, a valuation methodology permitting only index payors to utilize simplified reporting would inappropriately discriminate against gross proceeds payors.

Point Two would eliminate the safety net caps. RMOGA strongly opposes this selection. Contrary to the state commentors' assertions, the safety net caps do not limit true-up to market value, they limit true-up to proceeds from numerous sales distant from the wellhead within a contrived zone. Industry has always contended that index prices, net of transportation costs, are more indicative of the market value of production at the lease than proceeds from numerous sales at remote locations which are then artificially allocated back to the lease. The safety net cap was negotiated to address disputes concerning market value, late payment interest on true-up payments, and the "higher of" valuation requirement imposed on index payors. The safety net caps were never intended to address price anomalies, nor do they result in a double adjustment to value. Therefore, the safety net caps cannot be abolished without reciprocal concessions to industry.

Point Three would retain the weighted average method but eliminate the fixed index method for determining the Index Pricing Point (IPP). RMOGA opposes Point Three as written because there is a genuine need for devising a simple alternative to determine the IPP. A "weighted average only" method was discussed and rejected by the Reg-Neg Committee. Similarly, an arithmetic average of IPPs based on physical connection rather than actual flow was rejected by MMS and the states. However, requiring lessees to weight average IPPs based on physical flow demands complex and burdensome tracing. For gas sold at or before reaching a split or multiple connect, weight averaging is impossible. Using the highest IPP is inappropriate because higher priced markets are often anomalous.

To achieve a method that would avert the weight averaging of numerous IPPs and permit the selection of a single IPP, industry agreed to an election of either the weighted average or the fixed index method. The Reg-Neg Committee acquiesced that using the highest or second highest IPP was the most equitable way to accomplish simplicity and still ensure sufficient value for royalty; the cost of simplicity for industry was paying at a higher price index. Thus, eliminating the fixed index method will actually increase complexity.

Point Four would change the safety net from a median value to the weighted average of all arm's-length gross proceeds in the zone. RMOGA opposes such modification. The Reg-Neg Committee discussed and ultimately rejected this alternative in favor of a median value because the potential exists that weighted averages could consign a disproportionate weight to market extremes. A median value calculation similar to a major portion analysis for Indian leases was recognized as a more reliable indicator, specifically to eliminate such anomalies.

Point Five would provide for transportation allowance deductions consistent with determination of the IPP using the weighted average method set forth in Option No. 3, Point Three, above. Because our members strongly oppose elimination of the fixed index method without substituting another simplified method, RMOGA opposes this option. We agree the transportation allowance should be consistent with the selected IPP; however, because a simplified IPP selection method will undoubtedly include "no flow" situations, transportation allowances cannot be limited to the actual rate paid. The maximum IT rate should be allowed in a "no flow" situation, and lessees should be allowed to deduct a *de minimis* rate.

Point Six would distinguish between transportation and gathering at the Facility Measurement Point (FMP). However, this very concept was rejected by the Reg-Neg Committee in its earlier negotiations as well as during the June 1996 meeting.

OPTION NO. 4

Point One is identical to Option No. 2, and RMOGA reiterates our objections here.

Point Two resembles Option No. 3, Point Two, except that gross proceeds payors would retain the option to apply a gross proceeds based residue value to the wellhead MMBtu with a self-implementing safety net based on the lessee's own residue and NGL gross proceeds. As stated above, RMOGA supports the elimination of the option to pay index on residue and gross proceeds on NGLs. However, while we support retaining the option for gross proceeds payors to apply a gross proceeds residue price to the wellhead MMBtu, we oppose the self-implementing safety net calculation for the reasons stated above in response to Option No. 2.

Point Three would determine the IPP by using the closest index pricing point to which the gas physically flows. RMOGA opposes such an approach. While this method is appropriate for single connects, and may also be possible for multiple connects, the Reg-Neg Committee concluded that for split connects, which often occur at market centers, a closest IPP simply does not exist. Therefore, this method will not work.

Point Four is identical to Option No. 3, Point Five, and RMOGA reiterates our objections here.

Point Five is identical to Option No. 3, Point Six, and RMOGA reiterates our objections here.

OPTION NO. 5

RMOGA is unequivocally opposed to Option No. 5. Option No. 5 completely repudiates the considerable commitment, money, time and effort that went into the entire negotiated rulemaking process!

RMOGA strenuously objects to the benchmarks as proposed in **Point One**, which we view as even more objectionable than the current benchmarks. First, MMS' right to base royalty value on the first arm's-length sale by a lessee's affiliate has never been established. Even though MMS requires that minimum value for royalty purposes must be the gross proceeds accruing to the lessee, the term "lessee" is defined by statute and regulation as "any person to whom the United States, and Indian tribe, or an Indian allottee, issues a lease, or any person who has been assigned an obligation to make royalty or other payments required by the lease. In fact, the Interior Board of Land Appeals, in *Shell Oil Co. (on reconsideration)*, 132 IBLA 354, 357 (May 11, 1995) held that "[t]he term lessee is specific and cannot be expanded to include an affiliate of the lessee". Therefore, MMS has no legal basis to regard proceeds received by a lessee's affiliate as the gross proceeds accruing to the lessee from the sale of gas. To attempt to establish the first bona fide arm's-length sale by the affiliate as the second benchmark is an invitation to litigation.

Second, determination of royalty value based on an affiliate's resales has historically been required by MMS policy and regulations in only two specific instances: resale by the affiliate in the same field as the first sale from the lessee to the affiliate, and resale by a marketing affiliate who acquires only the lessee's production and markets it. Through this proposed mechanism, MMS attempts to reestablish the royalty valuation point further downstream from the lease, yet MMS refuses to share in the risks and expenses in participating in downstream markets.

Third, calculating royalty value based on an affiliate's resale firmly ensconces royalty valuation in the post-1988 regulatory era. It should be noted RMOGA's intent in participating in the negotiated rulemaking process was to implement a valuation methodology under which lessees would <u>not</u> be required to trace gas downstream through hundreds of separate sales and recalculate the royalty value each time retroactive adjustments are made for each downstream disposition. With this scheme, all the problems experienced under the 1988 regulations would be exacerbated, especially in those instances where a lessee must depend on another entity for information necessary to calculate royalty value.

MMS has stated it would draft a separate proposed rule on the issue of improved benchmarks. However, before proceeding with further rulemaking on the benchmarks, MMS must give serious consideration to the comments and suggestions which were made during the Reg-Neg Committee negotiations. RMOGA urges MMS to formulate benchmarks that establish royalty value based on arm's-length sales occurring at or near the lease; that preclude legal disputes over gross proceeds, FERC 636 transportation issues, and affiliates' sales; and that eschew complex and burdensome allocations mandating endless tracing.

Point Two would adopt the Reg-Neg Committee's recommendation for entitlements based reporting for mixed agreements, but would eliminate the exception for small producers. RMOGA strenuously objects to this proposal. It discriminates against small producers and fails to provide any meaningful exception to entitlements based reporting, a concern which has been reiterated over and over again throughout the negotiations and in comments on the Concensus Rule.

RMOGA strongly supported this exception in our comments on the Concensus Rule, and has never been under the impression that significant objection to such an exception existed. During the June 1996 meeting, the Reg-Neg Committee concurred that an exception is essential. In fact, RMOGA would support further expanding the definition of a small producer and extending the six-month time period after the production year in which the small producer may true up to its entitled volumes and pay additional royalty due without incurring interest, as suggested by the Unified Proposal.

Point Three proposes including a provision for takes based reporting for 100% federal and stand alone leases. As RMOGA commented on the Concensus Rule, we support this recommendation by the Committee. However, we again caution MMS that:

> "[t]he Committee's recommendation is not accurately reflected in the MMS' concurrent proposed rule on "Payor Liability". Specifically, the language in the Payor Liability rule excludes any exception for entitlements. We urge the Committee's recommendation be stated verbatim in the final gas valuation regulation as well as in the proposed Payor Liability rule to reduce any confusion that may arise where it could be construed that all payors will be required to pay on a pure entitlements basis, and so the issue will not be dependent upon adoption of the payor liability rules". (RMOGA comments, February 5, 1996.)

Point Four is identical to Option No. 3, Point Six, and RMOGA reiterates our objections here.

ADDITIONAL OPTIONS

In addition to the Unified Proposal and MMS' five proposed options, two other proposals were offered during the June 1996 Reg-Neg Committee meeting. RMOGA offers its specific comments on those proposals below.

New Mexico Proposal

1. **For split/multiple connects, determine the IPP using the weighted average method.**

   This is identical to Option No. 3, Point Three, and RMOGA reiterates our objections here.

2. **Determine the location differential/transportation allowance based on weighted average and actual flow. The location differential would equal the lessee's actual costs to the IPP. In no flow situations, index would be applied at the wellhead with no location differential. For non-arm's-length/non-jurisdictionaltransportation, the allowance would equal lessee's actual cost, or the *de minimis* rate with MMS approval.**

RMOGA's objections to determining the IPP and location differential based on weighted average and actual flow are discussed above under Option No. 3, Point Five. RMOGA opposes any valuation method that attempts to establish value at sales points distant from the lease without providing any transportation allowance. In addition, requiring prior MMS approval to deduct a *de minimis* rate would simply increase both the lessee's and lessor's administrative burden without any benefit, since it is a minimum rate calculated by MMS.

Delete options for index payors to pay index — and for gross proceeds payors to pay the gross proceeds residue price — on a wellhead MMBtu. Retain the 50% safety net cap.

RMOGA is strongly opposed to this option. Please see our comments on Option No. 3, Point One, above.

4. **Delete deepwater exceptions.**

RMOGA's members strongly oppose this proposal. No state is affected in any way by deepwater issues contained in the Concensus Rule. MMS should weigh only the comments of those who have an interest in deepwater production.

5. **If MMS fails to calculate the safety net in two years, it must keep the states whole, i.e, calculate and pay interest to the states as if additional royalties had been paid.**

Please see RMOGA's comments on Option No. 1, Point Five, above. Since RMOGA members would not be affected by a provision requiring MMS to keep the states whole in the event MMS is unable to calculate the safety net within two years, we do not take a position on this issue.

. **No exception for gross proceeds payors to value small volumes of non-sale non-arm's-length dispositions on non-arm's-length benchmarks rather than index.**

RMOGA opposes this proposal and agrees with the Reg-Neg Committee's acknowledgement that an exception must be provided.

7. **Committee concensus would apply to gathering and transportation.**

RMOGA agrees.

State of Montana (Wanda Fleming) Proposal

1. **Value royalties on index in accordance with the Concensus Rule, including wellhead MMBtu reporting but without a location differential or transportation allowance. Eliminate the safety net calculation and associated true up.**

RMOGA cannot support any valuation methodology that does not allow for a deduction of transportation costs. Such methodology would shift the royalty valuation point away from the lease to a distant IPP and disregard the Reg-Neg Committee's rejection of such methodology, thus tempting legal challenge. Moreover, this concept is based on the misperception that federal lessees are realizing an uplift over the index price that is equivalent to their transportation costs. However, there is no evidence to support such a conclusion. As you know, efforts by the Reg-Neg Committee to compare gross proceeds received by MMS with index prices, for the purposes of determining a correlation between the two, were inconclusive (see Committee Report, page 14). Elimination of the transportation allowance would have a serious detrimental effect and would disproportionately impact individual lessees, particularly smaller producers, based on the cost of transportation, distance to the IPP, and other mitigating factors.

2. **No exception for gross proceeds payors to value small volumes of non-sale non-arm's-length dispositions on non-arm's-length benchmarks rather than index.**

   Please see RMOGA's comments on Point 6 of the New Mexico Proposal above.

3. **Committee concensus would apply to gathering and transportation.**

   RMOGA agrees.

MMS/STATE PROPOSAL (OPTION NO. 9)

1. **Index/No Location Differential/No Safety Net.**

RMOGA certainly would support eliminating the safety net. We believe it is an unnecessary yet immense administrative burden on the MMS that serves only to add complexity and uncertainty to the alternative valuation methodology.

Please see RMOGA's comments on the State of Montana Proposal above with respect to the location differential.

2. **Determine the IPP using the weighted average method.**

   This is identical to Option No. 3, Point three, and RMOGA reiterates our objections here.

3. **Determine the IPP using any single valid publication.**

RMOGA supports this proposal and understands it was agreed to by the Reg-Neg Committee at its June 1996 meeting.

4. **Committee concensus would apply to gathering and transportation.**

   RMOGA agrees.

5. **For index payors, allow wellhead MMBtu reporting on processed gas.**

   RMOGA supports this proposal as it achieves the Committee's objective of simplicity.

6. **For mixed agreements, producers whose total monthly royalty payments on federal leases total less than $5000.00 qualify to pay on takes.**

RMOGA supports the exception set forth in the Unified Proposal. The $5000.00 figure has no apparent basis, and fails to provide a meaningful or practical exception to entitlements for small producers, as intended.

7. **No location differential.**

See our comments on Point 1 of this MMS/State Proposal, above.

<u>MMS/STATE MODIFIED PROPOSAL (OPTION NO. 10)</u> (modifies Option No. 9)

1. **Index payors would true up to 100% (no safety net cap) of the MMS calculated safety net value. The safety net value would be the weighted average of a stratified sample of arm's-length gross proceeds (including affiliate resale proceeds) accruing to gross proceeds payors and index payors in the zone. The safety net would be published in two years based on audited product codes 03 and 04.**

RMOGA opposes elimination of the safety net caps for the reasons outlined in our response to Option No. 3, Point Two, above.

RMOGA opposes basing the safety net calculation on a weighted average rather than a median value for the reasons outlined in our response to Option No. 3, Point Four, above.

RMOGA opposes use of a stratified sample to calculate the safety net because we believe it would be impossible to implement. Where the stratified sample included sales from pools, MMS would have to calculate the applicable pool price from hundreds of separate sales and transportation transactions. Extrapolations would have to be made based on numerous assumptions, which seems only to add an element of vagueness to the process. Moreover, it is unlikely a safety net value could be calculated and published on a timely basis.

The tremendous administrative burden on MMS to implement this procedure should not be underestimated. It is difficult to imagine that a safety net calculated on the weighted averaged of a stratified sample could be less complex than one based on MMS 2014 data. This procedure would also spark numerous challenges by lessees disputing assumptions, gross proceeds, allowable deductions, affiliate resales, and conceivable challenges to MMS' sampling techniques themselves.

Determine the IPP using the weighted average method.

This proposal is identical to Option No. 3, Point Three, and RMOGA reiterates our objections here.

3. **Determine the IPP using any single valid publication.**

RMOGA supports this proposal and understands it was agreed to by the Reg-Neg Committee at its June 1996 meeting.

4. **Committee concensus would apply to gathering and transportation.**

RMOGA agrees.

5. **In order to report and pay processed gas royalty on a wellhead MMBtu basis, add 2% to the applicable index or gross proceeds residue price.**

RMOGA strongly opposes this proposal because it erroneously assumes — without any evidence to support such an assumption — that there is always a 2% uplift in value from processing. Further, the Reg-Neg Committee considered and rejected the concept of "Index + X" because it was agreed that it would be impossible to determine the value of "X".

6. **For mixed agreements, producers whose total monthly royalty payments on federal leases total less than $5000.00 qualify to pay on takes.**

See RMOGA's comments on Option No. 9, Point 6, above.

7. **Arm's-length and jurisdictional transportation allowances should be based on the actual rate paid. Non-arm's-length, non-jurisdictional transportation allowances be limited to actual costs, or a *de minimis* rate with prior MMS approval.**

RMOGA opposes this proposal and recommends MMS implement the Reg-Neg Committee's concensus. RMOGA generally recognizes that the transportation allowance should be consistent with the IPP selection method; however, as stated above, RMOGA's members oppose the elimination of the fixed index method without substituting another simplified method. Therefore, this proposal is unacceptable. Transportation allowances cannot be limited to the actual rate paid because a simplified IPP selection method will certainly include no flow situations which necessitates using the maximum IT rate. Finally, requiring prior MMS approval to deduct *de minimis* rates increases the administrative burden since it is a rate already calculated by MMS.

Conclusion

In conclusion, RMOGA members are deeply disappointed that MMS has chosen to accord such significance to the comments of the states, while virtually ignoring the comments of the small independent producers that were submitted on the Concensus Rule, both in its proposed "Options for Proceeding With the Further Rulemaking" and during the Reg-Neg Committee Meeting in June 1996. We are concerned that MMS chose to depart from the Concensus Rule without better attempting to balance the concerns of industry with those of the states. We are disturbed that MMS chose to caucus with the states during the June Committee meeting, particularly in view of the movement away from the Concensus Rule and toward the states' position.

RMOGA stands firmly behind the Unified Industry Proposal, both as submitted and as modified. The Unified Proposal is the only proposal which adheres closely enough to the Concensus Rule (which RMOGA supported and continues to support), while still addressing the concerns of independent producers and the states, to satisfy our members.

Proposed Option No. 1, which is the most akin to the Concensus Rule of the MMS options, could conceivably be sufficiently modified to address industry's concerns, but, as proposed, fails to acknowledge the comments of the independent producers and poses other problematic conditions, and is therefore unacceptable. Options Nos. 2 through 5 depart so significantly from the Concensus Rule as to be almost totally unredemptive. Rather than progress, these options regress, and fail to achieve few, if any of the objectives set forth by the Reg-Neg Committee.

While there are certain elements of the proposals presented during the Committee meeting (New Mexico, Montana, and MMS/States) that RMOGA supports, there are many more elements which RMOGA members find highly objectionable and could never advocate.

RMOGA is extremely concerned that MMS appears to be willing to discard the negotiated rulemaking process so capriciously. The members of the Federal Gas Valuation Negotiated Rulemaking Committee worked for over two years to develop a practical alternative to the current gross proceeds and benchmarking valuation principles. The cost in time, travel and lodging expenses incurred by Reg-Neg Committee members is gigantic. To now depart significantly from the Concensus Rule without addressing industry's concerns would be unconscionable. Moreover, the Administration would almost certainly find it difficult to locate willing participants should it decide to pursue a negotiated rulemaking effort in the future, assuming the Negotiated Rulemaking Committee is accorded equal or less bearing than the public comment process.

Finally, MMS must consider the potential impact of other initiatives on the Federal gas valuation rulemaking, particularly the recent proposed rulemaking to implement FERC Order 636. Although we have not had time to analyze them in detail, the FERC 636 proposed rules appear to move the point of valuation even farther from the lease than the gas valuation regulations do. It is essential the rules implementing Order 636 be closely integrated with the gas valuation regulations. To the extent we find inconsistencies between the gas valuation regulations and the proposed FERC 636 rules, we will so remark in our comments on the FERC 636 rule. We urge MMS to consider the comments on both rules collectively and to promulgate both sets of regulations simultaneously.

Thank you for your consideration of our comments. Please feel free to contact me if you would like to discuss RMOGA's comments in further detail.

Very truly yours,

Carla J. Wilson

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UNIFIED INDUSTRY PROPOSAL

Retain the Committee's index-based method but simplify the rule as follows:

1. Write the final rule in plain English.

2. Include a provision for takes basis reporting for 100% Federal agreements and stand-alone leases. Also, an exception would be provided to pay on other methods when all of the parties agree as specified in the Committee Report.

3. For mixed agreements reporting, the exception would be expanded to an average of 500 barrels of oil per month per well or 3,000 MCF per month per well, or combination thereof[1], determined by dividing the average daily production from all wells on a lease by the number of such wells. For the producer who pays on a takes basis, the time period to reconcile to entitlements would be extended to two (2) years. For adjustments to entitlement based payments, reciprocal interest would apply to the amount of the adjustment, i.e., the producer pays interest when adjustments are made for undertakes and the MMS pays interest when adjustments are made for overtakes. Interest would not begin to accrue on the adjustment amount until the first month following the two year period.

4. Delete the second sentence in proposed 30 CFR 202.450(b) which otherwise would deny royalty-free use of gas downstream of the FMP.

5. MMS would issue separate guidance on the reporting of gas valuation consistent with the recommendations of the Royalty Policy Committee's Subcommittee on Royalty Reporting and Production Accounting.

6. The Index Pricing Point would be determined by using any single valid publication. The producer would select the single valid publication on a zone-by-zone basis at the beginning of every year.

7. Index would be applied to the wellhead MMBtu less a location differential to the appropriate Index Pricing Point. There would be no option to value residue gas on index. For split connects or multiple connections the producer would use either a weighted average or an arithmetic average of the published indices from any single valid publication less the applicable location differential. Refer to the Committee Report, Index Pricing Point (IPP) on page 18. After the first option, Weighted Average, replace the second option as follows:

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[1] This exception would be on a per well basis for both production and injection wells.

2. An arithmetic average of all the physical connections based on the single valid publication.

8. Gross proceeds payors would have the option for all Federal leases inside or outside an index zone, on an annual basis, to elect to apply a gross proceeds based gas value to the wellhead MMBtu less applicable transportation with no safety net. Producers would still pay on gross proceeds on arm's-length dedicated contracts.

9. For all arm's-length and/or jurisdictional transportation, the location differential would parallel the Index Pricing Point valuation methodology. For transportation that is both non-arm's-length and non-jurisdictional, the producer would use the Committee's recommendation. The *de minimis* transportation rate would apply to both gross proceeds and index payors and would not require prior MMS approval.

10. Retain the Committee's recommendations concerning the distinction between transportation and gathering.

11. In order to relieve those paying on gross proceeds from a higher audit burden and relieve the MMS of the administrative burden of auditing the gross proceeds MMS-2014's prior to calculating the safety net, the MMS would calculate the safety net price using only unaudited gross proceeds as reported on MMS-2014's, including any out of period adjustments, but only for the index year for which the safety net is being calculated. The index payors would true up to 75% of the difference between the index payor's weighted average index based value and the median price for unaudited gross proceeds on a zone-by-zone basis. Any safety net adjustment required as a result of any comparison would be accomplished by a one line entry on a zone-by-zone basis. The alternative valuation method would not shift the audit burden to the gross proceeds payors.

12. If the safety net is not published within one (1) year following the end of the index year, then no additional royalty would be due and the index would become the final safety net.

13. Any royalties paid for gas contract settlements proceeds would not be considered gross proceeds for safety net calculation purposes.

14. Gross proceeds payors would be allowed to value small volumes of gas sold non-arm's-length in accordance with its arm's-length transactions and would not be required to use index pricing.